

**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

In the Matter of the Federal-State	)	CC Docket No. 96-45
Joint Board on Universal Service	)	
Request for Comments on Certain of the	)	
Commission's Rules Relating to High-cost	)	
Universal Service Support	)	

**REPLY COMMENTS OF THE  
MONTANA PUBLIC SERVICE COMMISSION**

**I. Overview**

The Montana Public Service Commission (Montana PSC) respectfully submits these reply comments in regard to the Federal State Joint Board's (Joint Board) August 17, 2005, public notice relating to high-cost universal service fund (USF) support. The Montana PSC thanks the Joint Board and Federal Communications Commission (FCC or Commission) for having initiated this important proceeding and for this opportunity to comment on the complex and interrelated federal USF funding issues raised.

On December 14, 2004, we filed reply comments regarding the Joint Board's related August 16, 2004, public notice. That notice identified three limited areas of inquiry: (1) whether a USF support mechanism for rural carriers based upon forward-looking economic costs or upon embedded costs would more efficiently and effectively achieve the goals set forth in the Telecommunications Act of 1996 (1996 Act); (2) the definition of a rural telephone company for high cost areas and for the consolidation of multiple study areas; and (3) whether to amend or modify § 54.305 of the FCC rules concerning the amount of USF support for transferred exchanges.

In its August 17, 2005, public notice the Joint Board seeks additional comment in this high-cost federal USF support inquiry. This recent notice

seeks comments on the four proposals that emerged from the Joint Board members and certain state staff. Complex and interrelated issues are raised by the four proposals, as is evident from the initial comments that have already been submitted.

The Joint Board's recent notice expands greatly the limited areas of inquiry that the Joint Board initially identified. The inquiry now appears to be rising to a level of comprehensive industry reform. We agree with the Joint Board and the FCC on the need for reform. As both markets and technology change, so must the rules and regulations that serve to achieve the fundamental goals of universal service. We do not, however, agree that the federal universal service system is broken.<sup>1</sup> Special interests will often disagree on what policies best serve to achieve the goal of universal service. There are reasonable actions that the FCC can take to address the problems that are driving the present efforts at reform. We have previously supplied both the Joint Board and the FCC with recommendations. We expand upon in these in the reply comment.

#### Penetration Rates are not a Measure of Universal Service Failure

We take this opportunity to first comment on the assertion that the "universal service system is broken." Qwest cites as proof that the system is broken the recent decrease in the penetration of phone service: "The universal service system is broken...the fundamental measure of success – penetration rates – has actually declined."<sup>2</sup>

The Montana PSC agrees with the FCC that one of the most fundamental measures of universal service is the number (and percentage) of households with telephone service. This is a measure of penetration. It does

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<sup>1</sup> See the initial September 30, 2005 comments of Qwest Communications International Inc. in this CC 96-45 Joint Board proceeding (p. ii).

<sup>2</sup> Id.

not follow, however, that based on a decline in the penetration rate that the universal service system is broken. Between December 1999 and June 2003, the total number of end user switched access lines fell from 189.5 million to 182.8 million, a decline of 6.7 million subscriptions.<sup>3</sup> For the same time period, however, mobile telephone service subscriptions rose from 86 million to 148 million, an increase of 62 million subscriptions.<sup>4</sup> On net then, from 1999 to 2003 the number of subscribers increased by about 55 million. To the extent that the net increase in wireless subscribers is in high-cost areas, the FCC's current policies reward wireless carriers that seek and receive ETC designation with the portable federal universal service funds that the ILEC receives.

Whereas penetration of phones in households did decline by 1.3 percent from 2003 to 2004, there was an enormous increase in the overall number of subscriptions.<sup>5</sup> The Montana PSC questions whether because of technologic change, evolving wireless technology, and other means of communications (*e.g.*, pagers, Blackberries, VoIP, cable telephony, etc.) a fundamental change has occurred in what measure of penetration is relevant. Is the "household" measure of penetration still an accurate portrayal of the

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<sup>3</sup> Source: FCC's Local Telephone Competition: Status as of June 30, 2003, Table 1, December 2003.

<sup>4</sup> FCC Ninth Report. Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services. September 28, 2004. Table 1. CTIA's Semi-Annual Mobile Telephone Industry Survey. WT Docket No. 04-111, FCC 04-216.

<sup>5</sup> We are unsure of whether this net change includes the increase due to other technology platforms that would logically increase the level of subscriptions. Principally we would recognize the large growth in DSL subscriptions (deregulated) by which customers can obtain VoIP voice connections. Another might include Cable telephony. Data improvements would only buttress our observation however. On the other hand, however, wireless subscriptions are not necessarily just for households, but no doubt include business subscriptions. Thus, there are complications in arriving at valid estimates of accessibility of telephone service.

accessibility of telephone service? Even if the household penetration rate had increased, other things being equal, instead of having declined, we doubt that the calls for reform of the federal universal service system would have been silenced.

### The Identical Support Mechanism Should Cease

We urge the Joint Board to recommend that the FCC change its policy of making universal service support for an ILEC ETC portable to CETCs. We do so primarily because there is an apparent and significant cost difference between wireline and wireless service, yet federal universal service funds continue to pour into the coffers of wireless carriers based upon costs that are utterly unrelated to the wireless carriers' costs of providing service.

Therefore, one means to increase the penetration of telephone service would be to hold down the cost of federal universal service funding that is ported to CETCs (*e.g.*, funds would then be available for rate reductions). This can be achieved by not porting an ILEC ETC's federal funding to wireless CETCs but rather by providing needed support based upon the wireless CETC's own costs. This is a reasonable solution, one that will stem the explosive growth in the high cost support. The Montana PSC would add that, consistent with the provision of § 254(b)(3) that comparable services be offered in rural, insular, and high cost areas, it does not oppose designating qualifying wireless carriers as ETCs. However, to do so by way of porting the ILEC ETC's federal funding will only serve to sustain unwarranted and unnecessary implicit subsidies.

In the balance of these reply comments we will respond to the initial September 30, 2005, comments that certain parties have filed. Our reply comments broadly fall into three topical areas: unified costing mechanism, block grants, and the affordability of service.

## **II. Unified Costing Mechanism**

### Embedded Costs for Rural Carriers

In our December 14, 2004, reply comments, we agreed generally with those initial commenters that support the continued use of embedded costs for rural companies. The Montana PSC's agreement reflects the administrative cost burden associated with using forward looking economic costs (FLECs) that would be imposed on rural carriers. We refer the Joint Board to those comments, as our opinions are unchanged. Few, if any, of Montana's small rural ILECs have the financial wherewithal to employ analysts, directly or indirectly by way of consultants, to perform such complex studies in addition to their obligation to maintain historical embedded (accounting) cost information. Some of these small rural carriers may have study areas that only include a handful of wire centers.

Rural telecommunications companies are also at risk if their actual embedded network costs are not reflected in the basis of their federal USF funding. As evident from CenturyTel, Inc.'s, September 30, 2005, initial comments (at pp. 3 and 13), because the size of the ILEC high-cost fund is capped, network costs do not decrease as lines are lost. Other things being equal, line losses will increase a carrier's average cost per line. The Montana PSC agrees with the CenturyTel policy recommendation that the Joint Board recommend that federal mechanisms support the entire rural network, including transport costs, that provide advanced services.

There also is a relationship between an issue in the Joint Board's initial August 16, 2004, public notice, that regards the cost basis of support, and the issue of providing block grants to states. As explained by Joint Board member Baum, the state allocation mechanism (SAM) may be implemented using either embedded costs of service (ECOS) or FLECs. We agree that either ECOS or FLECs could be used as the basis of a rural company's federal universal service funding. The merit of using embedded costs does not, and should not, depend upon whether the current rural support mechanism

continues or a SAM is implemented. For purposes of rural high cost support embedded costs are relevant costs.<sup>6</sup>

Most Efficient Technology and Identical Support: Implicit Subsidies

We disagree with the SAM's use of a "most efficient technology" approach to allocate federal universal service funds to states. While the most efficient technology approach may, initially, appear reasonable, if one scratches lightly at its surface, previously obscured cream-skimming and implicit subsidy problems emerge. We refer the Joint Board to Western Wireless's cost comparison for wireline and wireless services:

Western Wireless Cost Estimates<sup>7</sup>

	<u>Wireline</u>	<u>Wireless</u>
Rural:	\$7,195	\$1,734
National:	\$2,492	\$920

To base a rural wireline ILEC's federal universal service support upon a wireless carrier's cost that appears to be reflective of the most efficient technology would be a serious policy error for the following reasons. First, a CETC that has lower costs may not serve all of the customers that the ILEC must serve. Although it is admittedly a small sample, nationally speaking, the wireless ETCs that serve Montana do not initially serve the entire study area, or wire center, of the ILEC upon which the ILEC's federal USF support is based. Second, the CETC may not provide the same services or service quality. As a CETC may not have the same geographic coverage or provide

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<sup>6</sup> The MPSC supports basing a carrier's support on its own costs (see MPSC's December 14, 2005 comments to the Federal-State Joint Board on Universal Service in CC 96-45; also see the MPSC's September 22, 2004 comments in response to the FCC's NPRM, CC 96-45).

<sup>7</sup> Source: The presentation of Western Wireless' CEO Stanton to the September 2004 Qwest Regional Oversight Committee.

the same functionality or service quality that an ILEC provides, the most efficient technology, and the identical support mechanisms, will likely discriminate against the ILEC that has the legal obligation to be the carrier of last resort for all customers, an obligation that is not, at least initially, imposed on CETCs.

These are reasons why the Montana PSC has disfavored both the identical support and the most efficient technology mechanisms and instead favored basing federal USF support on a rural carrier's own costs.<sup>8</sup> The most efficient means to address the unnecessary ballooning of the high cost fund is to base each CETC's federal USF support on the CETC's own costs.<sup>9</sup> The existing "identical support" mechanism should be eliminated and the most efficient technology mechanism should not be adopted. We urge the Joint Board to endorse this proposal in its recommended decision to the FCC.

Whereas the last comment above deals with the problems that arise when an ILEC's support is based on the most efficient technology, similar problems will arise if a CETC's federal USF support is based upon the ILEC's support. Based on the above Western Wireless cost data, wireless technology appears to be most efficient. Assuming Western Wireless' cost estimates are accurate, then by basing the support for wireless CETCs upon the cost for the wireline ILEC will sustain an extraordinary and unjustified implicit subsidy for wireless CETCs. Even though the Western Wireless cost estimates are not representative of any particular carrier's costs, the comparison reinforces

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<sup>8</sup> There is another practical concern with implementing a most efficient technology approach. If a most-efficient technology approach were adopted, then the complexity of cost analysis would, it seems, need to expand to include modeling of all possible technology platforms (wireless, cable, satellite etc.). How else could one conclude that it is in fact most efficient?

<sup>9</sup> For a good summary of Federal universal service funding that, in turn, illuminates clearly the problem source (CETC designations) see the September 30, 2005 Initial comments of Balhoff and Rowe (Fig. 4).

the Montana PSC's recommendation that ILEC costs should not be portable to CETCs. An ETC's federal USF support should be based on the ETC's own costs. This change alone would obviously aid in controlling both the size and the rate of growth of the federal universal service fund. In this regard, the Montana PSC agrees with OPASTCO (initial comments, pp. 5-6) that Joint Board member Gregg's three-step proposal has merit in how it would base support for ETCs on each ETC's own embedded costs.

The Montana PSC is uncertain about, and does not yet have confidence in, the Joint Board staff's proposal to establish a separate wireless "portability fund." Although others may perceive merit in the proposal (see, *e.g.*, Western Telecommunications Alliance and the Independent Telephone and Telecommunications Alliance, initial comments, pp. ii, 14, 17, and 20-21), the absence of an explanation as to how such a fund would be established and in how it would be portable is problematic. Once the Joint Board staff's plan is fully developed, we will be willing to provide comments. In any event, a separate wireless portability fund is not necessary if the FCC would base support for each ETC upon each wireless ETC's own costs.

### **III. Block Grants, State Allocation Mechanism**

#### Block Grants, Cost Modeling, and State PSC Resource Limitations

Numerous parties filed initial comments on block grants. We understand that with such a mechanism states would receive lump sum grants that states would, in turn, disburse to ETCs. The Montana PSC disfavors such proposals, as do many of the parties that filed initial comments in this inquiry. We agree with the objections to block grant proposals that the Montana Independent Telecommunications Systems has

raised in its September 30, 2005, initial comments (at p. 4).<sup>10</sup> The Joint Board and the FCC should be aware of the resource constraints that small state commissions face and our consequent inability to engage in efforts to allocate federal universal service funds to carriers. While we lack the resources to manage complex models such as the FCC's FLEC model, we do have both the resources and the expertise to decide § 214 ETC designation petitions and to carry out our ongoing annual responsibilities that include certification and ensuring that federal fund receipts are used for the purposes intended.

#### Universal Service Funding: Freezing Support

Various parties oppose freezing universal service support. The Montana Telecommunications Association asserts that a freeze would be contrary to the intent of the federal universal service funding as it will eliminate the incentive to invest in rural infrastructure and it will raise questions as to whether the fund is, as Congress has required, sufficient.<sup>11</sup> Western Telecommunications Alliance and the Independent Telephone and Telecommunications Alliance disfavor freezing high cost support at second quarter 2006 levels, as such a proposal has no relation to the reasonable and prudent costs that need to be recovered (initial comments, pp. ii and 14). The Montana PSC is also concerned that the Joint Board might recommend, and the FCC might adopt, a freeze on the total universal service allocations based, for example, on a static test year such as 2004. The Montana PSC opposes a freeze regardless of how it is implemented. A freeze is entirely

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<sup>10</sup> Among the concerns that MITS raised are: 1) lack of specificity as to how such a mechanism (SAM) would work; 2) lack of state expertise; 3) likely politicization of process; and 4) the regulatory burden.

<sup>11</sup> See the Initial September 30, 2005 comments of the Washington Independent Telephone Association, Montana Telecommunications Association and Monroe Telephone Company.

inconsistent with § 254 of the 1996 Act and will only lead to protracted battles over the shares of a diminished federal universal service fund. If the growth in the federal universal service fund is to be restrained, there are far better means to do so than by a freeze.

### Block Grants and Statewide Cost Averaging

The Montana PSC agrees with the comments of the Interstate Telecom Consulting, Inc. (ITCI), that block grants, in combination with statewide cost averaging, will reduce the federal support targeted to small rural carriers most in need, while RBOCs will receive more federal support. The Montana PSC expects this result to occur when carriers that serve rural areas have their relatively high costs averaged with the costs of other low-cost areas. In the case of a carrier or multiple carriers, whether rural or non-rural, the averaging of costs over larger and larger areas runs contrary to the goal of making implicit subsidies explicit. Consolidation increases implicit subsidies as the costs to serve low cost areas dilutes and conceals the cost to serve high cost areas.<sup>12</sup>

ITCI identifies as another related problem that RBOCs are unlikely to invest in upgrades to their rural exchanges. ITCI adds that many of their regulators do not have authority over the rates or costs of RBOCs (ITCI initial comments, pp. ii-iv and 13-15). ITCI expects such conduct on the part of RBOCs because of the obligations to shareholders. The Montana PSC is uncertain of ITCI's prediction, but the concern may have some validity. In Montana, Qwest received about \$1.3 million in federal universal service

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<sup>12</sup> For example, if each of two carriers have the same number of customers but one carrier has costs of \$900 per subscriber while the other carrier has costs of \$100 per subscriber, the average cost for both carriers will be \$500. If a benchmark below which Federal universal service support is disallowed is \$400, the lower cost company would receive no funding absent cost averaging. And with cost averaging the higher cost carrier in effect subsidizes the lower cost company, thereby forgoing support that is rightfully its own.

support in 1998, an amount that grew to about \$16 million in 2004. In contrast, whereas Qwest's construction expenditures in 1998 were about \$35 million, its expenditures declined to about \$24 million in 2004. The Montana PSC does have rate regulation authority and is in the process of investigating what is the best use of federal universal service fund receipts for Qwest.

#### **IV. Affordable Service**

The Montana PSC has particular interest in the proposals to base support, in part, on estimates of the affordability of service. These proposals arose in both the proposals of the Joint Board members and in certain of the initial comments. Section 254 makes affordability one of the principles upon which policies shall be based that preserve and advance universal service. Affordability is not the only principle, however, that must be considered.

Although the Montana PSC is not opposed to considerations of affordability, it recommends a cautious and deliberate approach to making any related policy changes based upon § 254 principles. Determinations of "affordability" will be complex, as evident from the near absence of a thorough vetting of the topic and as telecommunications service affordability has at least several dimensions. As proffered by one or more Joint Board members, one dimension is the affordability of service in comparison to income. The Montana PSC is acutely aware of the Montana's relative income position. Montana's median household income in 2002 ranked 5<sup>th</sup> from the bottom nationally and was the lowest of all surrounding states.<sup>13</sup> We have exorbitant energy bills due to high energy costs combined with severe weather conditions. Household energy burden is a measure that has been maintained and used as an indication of need for targeted low income bill assistance. Telecommunications is also costly, as evidenced from the high

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<sup>13</sup> Source: United States Department of Agriculture. Economic Research Service. The national average median household income was \$42,409 in 2002 while Montana's median household income was \$34,105

cost support that is received by carriers who serve Montana's rural high cost areas. A comparable metric for household telecommunications cost burden may be of value in assessing affordability and universal service goals.

On the basis of these observations, Montana might fare well if an affordability index is implemented. Anyone can, as evident from this expanded inquiry, propose an affordability analysis, but it will be no simple matter to implement a reasoned approach. Before the Joint Board makes a recommendation to the FCC on such a matter, it should seek considerably more information than was provided in this expanded inquiry.

## **V. Conclusion**

The Montana PSC urges the Joint Board to move forward with this inquiry on the reform of the federal universal service mechanisms. We recommend that the Joint Board reject recommendations to adopt block grant mechanisms (such as the SAM) and a most efficient technology basis of allocating costs to states or any freeze on high cost funding. We recommend that the Joint Board endorse a funding mechanism that would compensate rural carriers for the embedded network costs that they incur. As a means to control the growth in the federal universal service fund and to limit the growth in implicit subsidies we recommend that each ETC's federal support be based on its own costs.

Submitted electronically this 31st day of October, 2005.

MONTANA PUBLIC SERVICE

COMMISSION

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